

Hawaii Condominium Bulletin

VOLUME 1 NO. 2

SPRING 1992

Funded through the Condominium Management Education Fund, Hawaii Real Estate Commission, State of Hawaii

Protecting Your Association's Money:

*Budgets, Reserves, Fidelity Bonds,
Financial Controls and Annual Audits*

Almost all associations collect money from their members — in many cases very substantial sums of money - to pay the association's common expenses. The wise use of and control over this money is one of the chief responsibilities of all condominium board members.

Budgets

Section 514A-83.6, Hawaii Revised Statutes, requires boards to adopt budgets and collect reserve funds for future major repairs.

Section 514A-83.6, Hawaii Revised Statutes, also restricts a board from exceeding the association's budget by more than 20 percent. However, a board may increase the budget to respond to an emergency situation. This section does not limit increases from one year to another. Nor does this section forbid an association from borrowing or imposing special assessments.

Reserves

Self-governance of condominium associations by boards of directors is a key element within the condominium property regime. However, by the enactment of Section 514A-83.6, Hawaii Revised Statutes, the Legislature expressed its determination that particular guidance was needed in the area of establishing adequate reserves. This determination was based on a number of considerations:

- The advancing age of many Hawaii condominium projects, and the resulting need for major maintenance and replacement of the common elements.
- The failure of some associations to prepare adequate budgets or to establish reserve accounts to handle long-term, major maintenance or replacement expenses, often resulting in large special assessments.
- The desire to stabilize maintenance fees and to allocate costs over time and among both current and future owners.
- The need for continuity, consistency, and fairness in the conduct of the financial affairs of the association as board members change.
- The scrutiny of an association's finances by astute purchasers and mortgage lenders before purchasing or lending.

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Letter from the Chair. . .

Dear Condominium Owners:

This issue of the Hawaii Condominium Bulletin is devoted to two major topics — dispute resolution and condominium finances. Resolving problems within condominium associations is the subject of this issue's Reference File. The other major theme of this issue is condominium association finances including fidelity bonds, financial controls, audits, and budgets and reserves.

In 1991, the Hawaii Legislature added a new section (Section 514A-83.6, Hawaii Revised Statutes) to the Condominium Property Regime statute. Section 83.6 requires condominium associations to establish and maintain adequate capital reserves for future major repairs. In 1992, the Legislature proposed amendments to the reserve statute to clarify further and to modify certain provisions of the law. Those proposed amendments have been sent to the governor for consideration.

The budget and reserve law does not become effective until January 1, 1993. Under currently proposed rules, condominium associations need not begin collecting reserves until the year 1994. The delay in the effective date of the law was intended to provide time for the promulgation of rules and to iron out any difficulties with the law.

The Commission has initiated both the preparation of rules to clarify and provide further detail on the reserve statute, and the development of a manual which will assist associations and managing agents in developing reserves. However, nothing in the present reserve law prohibits those associations which currently do not have reserves, or have materially under-funded their reserves, from beginning to fund adequate reserves using basic criteria such as what item(s) must the association replace or repair, when must those items be replaced or repaired, and how much will it cost to perform such replacement or repair.

For immediate assistance in learning more about dispute resolution and condominium finances, please see the other articles in this issue of the Hawaii Condominium Bulletin. I hope you will find the information useful and hope also that it will eliminate misconceptions or reduce anxieties you may have about the law.

Should you have questions concerning the information we have sent you, please feel free to write to or call (586-2646) the Commission's condominium specialists.

Very truly yours,

Stanley M. Kuriyama

*Chairman, Condominium and
Cooperative Review Committee*

Ask the Condominium Specialists

What is cumulative voting?

According to Robert's Rules of Order, Newly Revised (1990 edition), for elections of board members (where several persons serve identical functions), an association's bylaws may permit an owner to cumulate his or her votes. If, for example, there are four board vacancies to be filled, an owner would have four votes to cast. Using cumulative voting, an owner could allocate any number of her votes (including all four votes) to a single candidate, and allocate her remaining votes (if any) to other candidates. To see if cumulative voting is permitted in your association, please consult your bylaws.

Section 514A-82(a)(1)(B), Hawaii Revised Statutes, states that condominium associations with more than one hundred apartments must have a board of at least nine members. But my association's bylaws only provide for seven. Which is correct?

Generally, the requirements of subsection 514A-82(a) do not apply to condominiums created before those requirements were added to the statute. In contrast, subsection 514A-82(b) states that its requirements apply to all existing condominiums. Therefore, if the bylaws complied with Chapter 514A-82(a)(1)(B) as it existed at that time, then the provision of the bylaws (calling for seven directors) would supercede the current provisions of subsection 514A-82(a)(1)(B).

When You Have Trouble With Your Condominium Association

What kind of trouble?

Condominium disputes may arise over a range of issues relating to the condition or use of the property (e.g. leaks, landscaping), house rule violations and enforcement (e.g. noise, parking), actions (or inaction) of the board or management (e.g. assessments, improvements), claims against owners and residents (e.g. damages to property), employment-related problems (e.g. resident managers), vendor complaints (e.g. new roof too hot, new paint peels), and neighborhood problems. The Reference File presents a discussion on how you can resolve problems with your board.

What can be done about it?

Condominium law is based on the principles of self-governance and self-enforcement. As a result, condominium owners must usually enforce the law and resolve their own disputes relating to condominium living and governance. The State of Hawaii, through the Real Estate Commission, has only *limited powers* to enforce the law for owners or to resolve owners' disputes. The Commission's enforcement powers are primarily limited to disputes about failure to provide information and mishandling of association funds. However, if you have any questions, call the Commission's condominium specialists at 586-2646. (From the Neighbor Islands, dial 1-800- 468-4644, extension 6-2646.)

One major exception is in the area of discrimination.

The State, through the Hawaii Civil Rights Commission ("HCRC"), will intervene in cases involving discrimination based on sex, race, handicap, marital status, parental status, or other bases. The federal government, through the Department of Housing and Urban Development ("HUD") will also intervene to prevent such discrimination. Both agencies try to encourage settlement but also have enforcement powers to prevent discrimination.

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Factors working AGAINST dispute resolution.

- Often a complaint concerns something the board has or has not done, and, thus, becomes an implicit (or explicit) criticism of the board.
- Owners often and unnecessarily phrase their complaints as criticism of the board — few people respond well to criticism.
- If a complaint does not concern the board, the board is often reluctant to become involved or help resolve the problem.
- Board members are not paid — few people like to have to resolve the problems of others, even when paid to do so.
- Property managers and managing agents sometimes have to manage more projects than they can comfortably handle.
- Board members do NOT have to know anything about running a condominium project to qualify for the position.
- Boards, not property managers or managing agents, make the final decision on most issues. Even if the property manager or managing agent agrees with an owner, the board may not.
- The law is complex (even attorneys often cannot agree on its meaning) and sometimes sets standards of operation which few associations can meet and which many boards regard as unnecessary interference.
- Condominium decisions are usually made on the basis of a majority vote of the owners or the board, yet many problems affect or are raised by individuals who comprise less than a majority of owners.
- Many owners do not wish to become involved in condominium governance, even in matters which affect them.
- Present methods of dispute resolution often prove inadequate. Property managers, managing agents, board members, and owners are not always trained or able to resolve disputes, leading to unnecessary frustration and expense.
- If a board does something for one owner, it may have to do it for all.

Factors working FOR dispute resolution.

- The board's fiduciary duty to owners imposes high standards and considerable liability on boards.
- Recent cases awarding large damage awards against boards and associations have emphasized the responsibility of boards for their actions.
- Hawaii's condominium property regime law (Chapter 514A, Hawaii Revised Statutes) promotes open government for condominium associations.
- Hawaii's condominium law mandates free access to relevant (although not all) information about a condominium. The State, through the Regulated Industries Complaints Office ("RICO"), will enforce that access.
- The Real Estate Commission is working to educate association and board members on their rights and responsibilities with respect to the proper operation and governance of a condominium project and to improve dispute resolution among owners, boards, property managers, and managing agents.
- The Hawaii Civil Rights Commission ("HCRC") and United States Department of Housing and Urban Development ("HUD") have strong enforcement powers to prevent unlawful discrimination.

Options for resolving disputes and conflicts

Discussion

Legal action is a time-consuming and expensive process. The first step toward the resolution of disputes should always be through discussion and communication among the parties to the dispute. This process will work better if owners adopt a systematic approach.

First, owners, including directors, should review and know the law and project documents. Boards have a lot of power and discretion. For example, the present law gives boards broad assessment powers with virtually no limits as long as the assessment is for a legitimate association purpose. For example, a board's decision about the project's decor may offend good taste but will probably be upheld. When a power is not clear, boards will probably receive the benefit of the doubt.

Living in a condominium means giving up some freedom of action. Owners should follow the law and project documents to prevent problems of their own making. If the house rules forbid lanai enclosures or bright colored awnings, do not erect them and expect the board to just ignore them.

If you are not sure about your own or the board's rights and responsibilities, you may call the condominium specialists.

If a problem occurs, follow procedures which provide a

good paper trail so the board cannot ignore you. For example, if you make an oral request or inquiry and do not receive a suitable response, follow it up with a letter to the manager or board. Ask to attend a board meeting to discuss your problem and try to suggest solutions. Ask for a response from the board by a reasonable date, and confirm the date in writing.

Remember, the board would probably prefer not to deal with your problem. They may try to avoid dealing with it unless you politely persist.

Be insistent but not abusive. Be sensible, reasonable, and polite. Try to avoid personal criticism. Do not engage in name-calling or turn the problem into one of personalities rather than the issues. Do not give the board or manager a reason to refuse to deal with you.

Try to win the support of as many other owners as possible. The larger your group, the less likely that the board can discount the validity of your problem.

If, despite following this advice, the problem persists or seems to be getting out of control, consider the Commission-sponsored mediation service developed specifically for condominium owners and residents.

Mediation

The Real Estate Commission sponsors a mediation service to bring the disputing parties together to discuss the problem. The service is operated through the Neighborhood Justice Center. Specially selected and trained mediators assist the parties in communicating about the issues, exploring possible solutions, and negotiating mutually acceptable settlements. Mediators do not impose solutions on parties to a dispute but try to help them reach their own solutions. If necessary, mediation services can be provided on the Neighbor Islands.

Mediation is very effective in settling disputes before they escalate to the point of arbitration or litigation. Anyone with an unresolved complaint or claim involving the condominium's board, management, residents (owners or tenants), or neighbors, may use the mediation service. Parties pay only a small filing fee to participate in the service. For more information call the Neighborhood Justice Center at 521-6767 or the Commission at 586-2646.

Arbitration

If the parties are still unable to resolve their conflict or the dispute is not appropriate for mediation, Chapter 514A provides for arbitration of disputes relating to the condominium property regime law, the declaration, bylaws, or house rules. Not all disputes can be arbitrated and arbitration of some disputes is subject to certain conditions. For example, an owner may only arbitrate a dispute concerning assessments claimed by an association if the owner pays the full amount claimed by the association and keeps all payments

current during the arbitration (§ 514A-90(d) and 514A-121(b)(5), HRS). Arbitration is simply a method of resolving disputes by submitting them to an impartial person who has the power to make a determination concerning the issues in controversy.

An arbitration hearing is similar to a court hearing. Sworn testimony and evidence may be presented as in any court, but the process is usually more flexible and informal. The decision of the arbitrator is binding and enforceable in circuit court.

A party who disagrees with an arbitrator's decision, usually called an award, may request that a circuit court modify, correct, or vacate an award. But the grounds for such requests are limited by state law and such requests are not commonly granted. Arbitration is appropriate for many condominium disputes. For more information about arbitration call the American Arbitration Association at 531-0541 or write to them at 810 Richards Street, Suite 641, Honolulu, Hawaii 96813.

Litigation

Any condominium dispute may be decided in a court of law (unless arbitration has been requested). Unless the lawsuit is filed in Small Claims Court, however, litigation can be expensive and time-consuming.

If you DO NOT file in Small Claims Court, and instead, take another type of action, YOU MAY BE LIABLE for the Association's Attorneys' Fees AND other expenses and costs, UNLESS you try to resolve your dispute through Mediation or Arbitration first. (§514A-90(c) - (d) and 514A-94, HRS, were amended in 1991.

Before 1991, an owner who filed suit against an association and lost the lawsuit was not necessarily liable for the association's legal fees and costs. (On the other hand, if an association sues an owner and the association loses, the association may be liable for the owner's legal fees and costs.) The 1991 amendment encourages owners to resolve their disputes via mediation or arbitration before filing a lawsuit.)

The Small Claims Division of the State's District Court is a court where certain types of claims are decided by a judge in a relatively simple and informal manner. Individuals may ask the clerk of the court for assistance in filing their claims. Parties to a dispute need not (but can) be represented by attorneys, and attorney's fees cannot be charged to the losing party. Parties cannot appeal from judgments of small claims court. Small claims court has the power to decide claims for money, usually to a maximum of \$2,500, but has only limited power to order parties to act or not act in a particular way.

For more specific information you should contact the

small claims court in your area. Consult your telephone directory's Hawaii State Government section under the heading 'Courts — District — Civil.' You may also ask at the courthouse for a copy of the booklet: "Questions & Answers - Your Guide To The Small Claims Court."

Removal of the board

State law provides specific procedures for removal of directors. (For matters not covered by state law, refer to your association's by-laws concerning removal of directors.) Apartment owners may vote to remove any board member, without cause, at any regular meeting or at a special meeting. If the president does not call a special meeting for removal, the meeting may be called by the petition signed by at least 25% of the owners. If the secretary or managing agent fails to call the special meeting within fourteen days of receiving the petition, the petitioning owners may send out notices setting the time, date, and place of the meeting. (§514A-82(b)(1), HRS)

Removal of directors usually requires the approval of at least 50% of all owners, that is 50% of the common interest. Some bylaws require only the approval of 50% of owners present at the removal meeting. Regardless, you will need the votes or proxies of other owners if you intend to remove the board or board members.

State law has specific provisions on soliciting and voting proxies (§514A-82(b)(3) and -82(b)(4); 514A-83.2, HRS). For example, if a board member plans to use association funds to solicit proxies, owners usually have the same right. To be valid, a proxy must be delivered to the association secretary or the managing agent by 4:30 PM on the second business day before the meeting. The proxy must include specific information about the proxy giver, the proxy holder, and the meeting. If you wish to solicit proxies using your own funds, you have the right to a list of all association members and their addresses.

Perhaps the major problem with removal is the ill-feeling it can generate. The aftermath of removal can be months of bitter infighting by those who have been removed. Frequently, removal is seen as not just a rejection of the board's policies but also as rejection of the board members, personally. Removal may be the only solution if the board shows a continuing unwillingness to do what it should.

HCRC and HUD (discrimination only)

The Hawaii Civil Rights Commission and United States Department of Housing and Urban Development have broad powers to help owners, but primarily in the area of discrimination. Either agency may investigate and prevent discrimination by condominium associations and their agents and employees on the basis of sex, race, color, ancestry, religion,

handicap, marital status, and parental status (children in the family).

For example, rules which restrict children but not adults from doing something, such as using the swimming pool, may be illegal discrimination. Rules which excessively restrict the number of people who may occupy a unit in a condominium project may be illegal discrimination, if they have the effect of restricting parents with children from living in the project.

Rules which impact handicapped residents may be illegal. For example, it may be discriminatory to prevent a resident who has difficulty breathing from installing an air-conditioner, even if the condominium rules prohibit air-conditioners. Also, handicapped residents may have a right to make certain types of changes to the project (ramps, handrails etc.) to assist themselves in having full use of the project or their unit.

If you believe you have been the victim of discrimination on any of the bases stated above, contact HCRC at 586-8636 or HUD at 541-1329.

Rights of Condominium Owners

So that each apartment owner may be informed and have a voice in the operation of the condominium, Hawaii law provides for a number of rights including notice of meetings, open board meetings, elections, removal of directors, voting, and personal access to condominium records.

Notice of association meetings must be mailed to owners at least fourteen days prior to the meeting. The notice must contain the date, time, and place of the meeting, the agenda, and a proxy form, if appropriate. (§514A-82(b)(3), HRS)

If a board member plans to use association funds to solicit proxies for the election of directors, the board must post notice at the project of the proposed solicitation at least thirty days before it occurs. The board also must permit interested owners to participate in the solicitation if they inform the board within seven days of posting of the notice. The association will then mail to all owners a proxy form, the name of each owner who is soliciting proxies, and a statement of 100 words or less giving the owner's qualifications to serve on the board and reasons for wanting to receive proxies. (§514A-82(b)(4), HRS)

An apartment owner may attend all board of directors' meetings, except when the board meets in executive sessions [defined below]. (§ 514-83.1, HRS.) Whenever practicable, notice of board meetings must be posted in prominent locations within the project 72 hours before the meeting or at the same time notice is given to board members. (§514-82(b)(9), HRS)

Owners may participate in any discussion at open

board meetings unless a majority of a quorum of the board votes otherwise. The board may vote to go into executive session to discuss and vote upon personnel matters or any potential or ongoing litigation. The board must first announce the nature of the business to be discussed in executive session. (§514-83.1, HRS) Minutes must be kept for meetings of both the board and the association. Board minutes must include the recorded vote of each board member on all motions except those voted on in executive session. (§514A-83.4, HRS)

Owners may vote by proxy if the proxy is delivered to the association secretary or the managing agent by 4:30 PM on the second business day before the meeting. The proxy must include the owner's name and signature, apartment number, the name of the person to whom the proxy is being given, the meeting date, and the date the proxy is given. It is valid only for the meeting to which it pertains and any adjournments. (§ 514A-83.2, HRS)

Owners have the right to ask the association for a list of all association members and their addresses. Before receiving the list, the owner may have to state in an affidavit that he or she will not use the list for any purpose other than to solicit proxies or inform owners of association matters. (§ 514A-83.3, HRS)

Bylaws may be amended at any time by the vote or written consent of 65% of all owners. In this instance, state law overrides any higher percentage for amendment required by the project's bylaws. Owners have the right to propose changes to the bylaws through a volunteer committee. The proposal must be accompanied by a petition signed by at least 25% of the owners. The board must then mail the proposed changes to the owners. *Sixty-five percent of the owners must approve the amendments within 120 days of the date of mailing.* (§514A-82(b)(2), HRS)

Owners may obtain copies of the association's condominium documents, including the declaration, bylaws, house rules, master lease, conveyance document, and public reports. The managing agent or association must provide the documents, but may charge a fee to cover reasonable costs of providing them. (§514A-84.5, HRS)

The association's most current financial statement and minutes of board meetings are available to any owner at no cost, or on 24-hour loan so the owner can make copies. Owners also have the right to examine all other relevant association documents including financial records, insurance policies, and contracts. In some cases, the board may require the owner to furnish an affidavit stating that the information is requested in good faith. Owners may also view documents relevant to association meetings, such as proxies, tally sheets, and ballots, for 30 days following the meeting. (§514A-83.5, HRS)

A majority of owners must approve any association borrowing. (§514A-82.3, HRS)

(continued from Page 1)

Establishment of reserves is also supported by professional property managers, financial institutions, and insurance companies.

Thus, Section 83.6, Hawaii Revised Statutes, requires all associations to begin planning for reserves after January 1, 1993. Generally, the reserve planning process requires each association to:

- 1. Identify what property will need repair or replacement**
- 2. Estimate how much longer each item will last.**
- 3. Estimate the approximate cost for each item.**
- 4. Divide the approximate cost by the estimated remaining life (for each item) to determine the reserve for each item.**

Fidelity Bonds

Section 514A-95.1, Hawaii Revised Statutes, requires associations to obtain fidelity bonds to: (1) protect association funds; and (2) ensure that associations adopt sound financial controls for handling those funds. The statute requires that the amount of the bond be equal to \$500 multiplied by the number of apartments, with a statutory minimum coverage of not less than \$20,000 and a maximum required by the statute of \$100,000. Generally, fidelity bonds provide that if an association suffers a loss due to dishonesty by any of the association's employees, officers, directors, or managing agent, if any, the association will be insured for the losses.

Financial Controls

Sound financial controls for collecting, depositing, transferring, and disbursing association funds reduce the risk of loss. Those controls should prevent any one individual (or entity) from having sole control over association funds and records without the supervision or participation of at least one other association owner, director, or officer.

Typical financial controls include, but are not limited to:

- **separate operating and reserve accounts for association funds only;**

- **restricted access to the reserve account (e.g., signatures by board officers only);**
- **countersignature requirements for larger checks drawn on association accounts;**
- **regular board review of association disbursements and managing agent's financial reports;**
- **regular board review and reconciliation of association disbursements and account statements from financial institutions; and**
- **annual audits; and automatic payment by a financial institution of recurring expenses (e.g. utility payments).**

In addition, Section 514A-97, Hawaii Revised Statutes, forbids commingling of an association's general operating funds with funds of other activities. The section also requires all funds collected by an association or managing agent be deposited in a Hawaii financial institution insured by an agency of the United States government, held by a trust company authorized by the State of Hawaii, or invested in United States government obligations. The section forbids transfers of funds by telephone.

Annual Audits

During 1991, the Legislature amended Section 514A-96, Hawaii Revised Statutes, to make annual audits mandatory for associations of 20 or more owners. This section also requires that associations make available copies of the audit report to owners. In 1991, the American Institute of Certified Public Accountants issued its new Audit Guide for Common Interest Realty Associations. The Guide provides standards to be applied by certified public accountants when conducting audits of condominium associations. (Among other things, the Guide also requires accountants to present information about reserves as part of the audit report.)

While there can be no guarantees against the misuse of funds, taking the steps outlined above will certainly go a long way toward protecting your association's financial health both now and for future years to come.

Directory of Services

CHANGES/CORRECTIONS to FALL 1991, vol.1, no.1

On the Move

Condominium Mediation Service

Neighborhood Justice Center521-6767
Inquiries and requests for mediation service. If necessary, mediators can fly to the Neighbor Islands to assist in mediation of condominium disputes.

NEW OFFICE & MAILING ADDRESS:
200 North Vineyard Boulevard, Suite 320
Honolulu, Hawaii 96817

Real Estate Branch

Condominium Specialists586-2646
Toll-free from the Neighbor Islands ONLY
1-800-468-4644 (ask for ext. 62643)

Condominium governance/management inquiries, Chapter 514A, Condominium & Cooperative Review Committee586-2644
Association project registration, managing agent registration, applications/forms

NEW OFFICE & MAILING ADDRESS (eff. 3-30-92):
250 South King Street, Room 702
Honolulu, Hawaii 96813

REAL ESTATE COMMISSION 1992 CONDOMINIUM AND COOPERATIVE REVIEW COMMITTEE MEETING SCHEDULE *

HRH Princess Victoria Kamamalu Building
1010 Richards Street, Second Floor
Honolulu, Hawaii

TIME	DATE	ROOM
9:00 a.m.	July 8, 1992	Exam/Conference Rm.
9:00 a.m.	August 12, 1992	Kuhina Nui Rm.
9:00 a.m.	September 9, 1992	Kuhina Nui Rm.
9:00 a.m.	October 14, 1992	Kuhina Nui Rm.
9:00 a.m.	November 9, 1992	Exam/Conference Rm.
9:00 a.m.	December 9, 1992	Kuhina Nui Rm.

*THIS SCHEDULE IS SUBJECT TO CHANGE. PLEASE RECONFIRM THE MEETING DATES AND TIMES WITH THE COMMISSION'S OFFICE.

The Hawaii Real Estate Commission is currently in the process of drafting the administrative rules relating to condominium reserves. As soon as they have been approved, the Hawaii Real Estate Center will release a manual on condominium reserves and will be holding workshops on the reserves issue in each county.

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This publication is designed to provide general information in regard to the subject matters discussed. This publication does not constitute legal, accounting, or other professional advice or service and should not be utilized as a substitute for professional service to address specific situations. If legal advice or other expert assistance is required, the services of a competent professional person should be sought.

Purchased or funded by Condominium Management Education Fund, Real Estate Commission, State of Hawaii.
Produced by the Hawaii Real Estate Research and Education Center, College of Business Administration, U.H.